IN THE

Supreme Court of the United States

OCTOBER TERM 1948.

No. 661

IN THE MATTER OF

SOUND, INC., A CORPORATION,

DEBTOR.

ATWELL BUILDING CORPORATION, A CORPORATION,
Petitioner,

vs.

SOUND, INC., A CORPORATION, AND FRED DONENBERG, TRUSTEE,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

VINCENT O'BRIEN,
Attorney for Petitioner.

THE GUNTHORP-WARREN PRINTING COMPANY, 310 WEST JACKSON, CHICAGO

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Authorities Cited.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner, Atwell Building Corporation, respectfully asks that a writ of certiorari may issue to the United States Court of Appeals for the Seventh Circuit to review a judgment of that court affirming a judgment of the District Court denying the petition of Atwell Building Corporation for possession of real estate.

JURISDICTION.

The jurisdiction of this Court is invoked under Title 28, U. S. Code, Sec. 1254(1), approved June 25, 1948, effective September 1, 1948.

The judgment of the Court of Appeals was entered December 22, 1948 (R. 112).

OPINION BELOW.

The opinion of the Circuit Court of Appeals appears in the record at page 109. It is reported in 171 Fed. (2d) 253. The District Court filed no opinion.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

Atwell Building Corporation demised premises to Sound, Inc. under a lease which provided that the lease should terminate *ipso facto* upon the filing of any petition in bankruptcy by or against the lessee.

A petition in bankruptcy was filed against the lessee, Sound, Inc., November 8, 1946 (R. 2), which proceedings, on February 17, 1947, were converted to proceedings for reorganization under Chapter X (R. 11, 15).

With knowledge of the pendency of the proceedings, the lessor accepted from Fred Donenberg, originally receiver and later trustee in bankruptcy, payments in the precise amounts set forth in the lease (see exhibits following page 68 of record). Thereafter, on March 27, 1947, Atwell Build-

ing Corporation filed its petition to obtain possession of said premises, setting forth the said provision of the lease and asserting that the lease had automatically terminated by reason of the institution of the bankruptcy proceedings (R. 19, 20).

The trustee in his answer to the petition contended that by reason of its acceptance of said payments without protest the lessor was barred by waiver and estoppel from maintaining its petition (R. 28, 29).

On uncontroverted facts the master in chancery concluded as a matter of law that the lessee by accepting such payments "waived its right to terminate the lease" (R. 74). The lessor's objections to the report were overruled and an order was entered approving the report and denying the lessor's petition (R. 77).

On appeal to the Court of Appeals the judgment was affirmed.

That court held that the provision was for the benefit of the lessor and that, therefore, the lease was terminable only at the lessor's option, and that the acceptance of the payments constituted an election to continue the lease in existence. It held it to be immaterial whether the provision of the lease was a conditional limitation or a condition subsequent.

Since at none of the times in question had there been any attempt by the trustee in bankruptcy to affirm the lease, it is implicit in the decision that such payments were not necessarily and as a matter of law merely for use and occupancy of the premises but, on the contrary, might be deemed to be rent under the lease depending upon the intention of the parties.

QUESTIONS PRESENTED.

It was and is the contention of the petitioner that the lease provision is a conditional limitation and that, accordingly, the lease was automatically terminated when the bankruptcy proceedings were instituted; that the doctrine of waiver and estoppel has to do only with conditions subsequent, in which termination depends upon the election of the lessor, and is thus inapplicable in the case at bar.

Accordingly, it was and is petitioner's contention that there was no lease in existence under which rent as such could have been paid, and that the payments therefore could only have been for use and occupancy.

In any event, it was and is petitioner's contention that pending an election by a bankruptcy trustee under order of court to assume or to reject the lease, all payments made by him are necessarily and as a matter of law merely for use and occupancy of the premises, for if it is considered that the trustee has paid as lessee, then such payments would constitute an assumption of the lease by him which would bar his right subsequently to reject the lease.

REASONS FOR GRANTING THE WRIT.

The discretionary power of this Court to grant a writ of certiorari is invoked upon the following grounds:

1. In holding that the trustee made such payments as lessee (rather than for mere use and occupancy) the Circuit Court of Appeals overlooked the point that under the Bankruptcy Act a trustee cannot affirm a lease without an order of court, and that payments if treated as rent and as if lawful, would necessarily constitute as much an affirmance as the lessor's acceptance. The decision of the Seventh Circuit is, therefore, in direct conflict with the rule announced by the Court of Appeals for the Second Circuit in *In re Walker*, 93 Fed. (2d) 281.

2. In addition, the Court of Appeals has decided an important question of Federal law which has not been, but which should be settled by this Court, namely: whether payments made by a trustee in bankruptcy prior to any election by the trustee to assume the lease can, as a matter of law, be anything more than mere payments for use and occupancy.

3. The Court of Appeals, contrary to the decision of this Court in *Finn* v. *Meighan*, 325 U. S. 300, 65 S. Ct. 1147, refused to enforce the right preserved to lessors in bankruptcy cases by Subsection (b) of Section 110, Title 11 U. S. C. A., and failed to observe the distinction made by that statute between automatic termination provisions and those which give the lessor merely an election to terminate.

WHEREFORE, it is respectfully submitted that this peti-

tion for a writ of certiorari to the Court of Appeals for the Seventh Circuit be granted.

Respectfully submitted,

VINCENT O'BRIEN,
Attorney for Petitioner.

VINCENT O'BRIEN,
105 South La Salle Street,
Chicago 3, Illinois.

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Respondents.

BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI.

STATEMENT OF THE CASE.

The essential facts are stated in the accompanying petition for a writ of certiorari.

JURISDICTION.

The jurisdiction of the Court is invoked under Title 28, U. S. Code, Section 1254(1), approved June 25, 1948, effective September 1, 1948.

OPINION BELOW.

The opinion of the Court of Appeals is found at record page 109, and is reported in 171 Fed. (2d) 253.

SPECIFICATION OF ERRORS.

If a writ of certiorari is issued, petitioner intends to urge that the Court of Appeals for the Seventh Circuit erred:

1. In holding that there was any lease in existence under which the trustee could pay rent.

2. In holding that such payments made by a trustee in bankruptcy during the period within which he may, under order of court, either adopt or reject the lease, may as a matter of law be for anything other than use and occupancy.

ARGUMENT.

I.

The Decision of the Court of Appeals, That the Payments Were Made by the Trustee for Rent Rather Than for Use and Occupancy, Is Erroneous and in Direct Conflict With the Decisions of the Court of Appeals for the Second Circuit.

As we shall later show, the provision of the lease, being a conditional limitation rather than a condition subsequent, the term ended upon the intervention of the bankruptcy proceedings and, therefore, the doctrine of election or estoppel had no application.

Assuming, however, the provision to be a condition subsequent and the intervention of the bankruptcy proceedings to be a breach, so that the lessor might, at his election, terminate the lease or keep it in effect, nevertheless, the acceptance of the payments made did not manifest an election to waive the breach, regardless of the general rule to the contrary.

When there is a bankruptcy or a receivership the rule is different. The lessor is not at liberty to reenter. For a reasonable time, the court lawfully withholds possession, even in cases in which the term has ended, and its officer thereby becomes liable to pay the fair rental value for use and occupancy. He doesn't pay as lessee, nor does he pay rent under the lease even though the amount fairly to be paid for use and occupancy is identical with that prescribed in the lease. He does not so pay because he cannot, inasmuch as such payment would constitute an affirmance of the lease, on his part, which may not be done without order of

court, for it may later appear that the trustee wishes to exercise the discretion which the statute gives him under court approval to reject the lease. "Payment of rent, as rent under the lease, would be as much an affirmance on his part, if lawful, as would the lessor's acceptance." And if the term has ended, there is no lease in effect under which payment could be made.

In *Model Dairy Co., Inc.* v. *Foltis-Fischer, Inc.*, 67 Fed. (2d) 704 (C. C. A. 2) the court said, at page 707:

> "The receiver does not take over the term, when he goes into possession by the court's order, or before his own election. * * * The court puts him there by its own power; the lessor has nothing to say about it. He must take what compensation the court chooses to give him, or he will get nothing; his acceptance cannot be a recognition of the term—[of one] whom he has no power to exclude."

And in *In re Walker*, 93 Fed. (2d) 281, the same court speaking of such payments said, at page 283:

> "* * * they are not payments of rent, that is of money due under the lease; and unless they are, their acceptance by the lessor does not recognize the continued existence of the term. * * * Such a debtor does not pay as lessee; it may not do so, it is forbidden to affirm the lease without order of the court, and the payment of rent as rent would be as much an affirmance, if lawful, as is the lessor's acceptance."

In *Palmer* v. *Palmer*, 104 Fed. (2d) 161, the same court stated, at page 163:

> "A lease, being property *cum onere*, does not pass to a trustee in bankruptcy, unless he adopts it. * * * the trustee need not pay the rent during the probationary period, and the court will hold off the lessor, and force him to be content with the value of the use and occupation meanwhile, though ordinarily it will fix that at the same amount as the rent. * * *"

Similarly, in *Fleming* v. *Fleming Hotel Co.*, 69 N. J. Eq. 715, 61 Atl. 157, it was held that acceptance of rent from the lessee receiver while he was in possession did not, *since he was bound to pay for the use and occupancy during the time he held the property,* amount to a waiver of the lessor's right of reentry.

In relying on the case of *Moffat Tunnel Improvement Dist.* v. *Denver & S. L. Ry. Co.*, 45 Fed. (2d) 715, the Court of Appeals overlooked the fact, pointed out in our reply brief, that the property in question in that case was not in court custody.

We submit that the Court of Appeals erred in concluding that even in bankruptcy cases "it is all a matter of intention" and that its decision is directly in conflict with the first ground of the holding in *In re Walker*, 93 Fed. (2d) 281 (C. C. A. 2).

II.

In Holding That a Trustee in Such Situation May Pay as Lessee, the Court of Appeals Has Decided an Important Question of Federal Law Which Has Not Been, But Which Should Be Settled by This Court.

It is apparent that the question discussed under the foregoing point is one which frequently arises in bankruptcy proceedings. As we have noted, there is a conflict in the decisions of the Courts of Appeals. Even in the decisions of the Second Circuit, the court, as a further reason for its conclusion, inquires into the facts to see whether a waiver existed under the general law. We submit that in bankruptcy or receivership matters the doctrine of waiver through the acceptance of such payments should have no application at all, since the court officer is not free to commit the estate and since he is under an independent duty

to pay rent for his use of the premises pending the time of his election to affirm or to reject the lease.

We have been unable to find any decision of this Court on that important question.

III.

The Decision of the Court of Appeals Is Contrary to a Ruling of This Court, in So Far as the Court of Appeals, in Effect, by Erroneous Application of the Doctrine of Waiver and Election, Refused to Enforce the Right Preserved to Lessors by Express Provision of the Bankruptcy Statutes, and Failed to Observe the Distinction There Made Between Automatic Termination Provisions and Those Which Give the Lessor Merely an Election to Terminate.

In its opinion the Court of Appeals erroneously concluded that it makes no difference whether the provision of the lease was a conditional limitation or a condition subsequent and that, in either case, it was obviously made for the benefit of the lessor, so that if the lessor did not want to treat the lease as terminated, the lease would continue in existence.

Lease termination provisions are of two types. The first type includes those which give the lessor the option to terminate or to forfeit upon the happening of a specified contingency. In the second type the provision is self-executing without need for any affirmative action and termination is, therefore, automatic upon the occurrence of the contingency. See Annotation in 115 A. L. R. 1189, 1191, and 168 A. L. R. 504, 506. These annotations show that the distinction is universally made.

The provision in the instant case is substantially identical with the one set forth in *Irving Trust Co., as trustee* v.

A. W. Perry, Inc., 293 U. S. 307, 311, 79 L. Ed. 379, 382. That case is therefore conclusive on the point. The court said, page 382:

> "By the terms of the contract the filing of the petition in bankruptcy was, of itself, and irrespective of the election of lessor or lessee, a breach of the lease. The claim of the landlord, consequent upon the breach, arose and matured at the moment of the filing of the petition."

The same conclusion was reached by the Supreme Court in respect of a similar lease provision in *Finn* v. *Meighan*, 325 U. S. 300, 65 S. Ct. 1147.

It follows that the effect is the same as if the term prescribed in the lease had expired by lapse of time. There was thus nothing left to pass to the bankrupt's estate. As stated in *Murray Realty Co.* v. *Regal Shoe Co.*, 193 N. E. 164 (N. Y.), page 165:

> "It is easy for the draughtsman of a lease to provide that an adjudication in voluntary bankruptcy shall terminate the lease only if the landlord shall so elect. That is not the language of the lease before us. By a process of judicial construction plain words—'ipso facto end and terminate'—are made to read as if they were a lessor's covenant merely. We are constrained to accept the construction of the trial justice and say that the clause under consideration is a conditional limitation by reason of which the lease expired upon an adjudication that the lessee is bankrupt. Bankruptcy constitutes a breach of the lease. It thereupon ends and terminates, ipso facto."

The latter case makes it particularly clear that the provision is not one "obviously made for the benefit of the lessor", as the Court of Appeals erroneously concluded. It also makes it clear that the term had come to an end just as effectively as if it had expired through lapse of time. Nothing short of a new lease could bind the parties.

It, therefore, follows that the doctrine of election or of estoppel is wholly inapplicable. It also follows that there was in existence no lease under which it could possibly be said that the trustee was paying rent. Accordingly, the payments made by him must, of necessity, be held as a matter of law to have been made for use and occupancy of the premises.

As said in *Jandrew* v. *Bouche,* 29 Fed. (2d) 346, at page 346:

> "Under the above construction the lease terminated with the adjudication in bankruptcy and the appointment of the trustee. Consequently, there was no rent to accrue in the future, and no lien under either the lease or the statute. Of course appellee was entitled to a lien for the rent earned and to be paid by preference at the same rate for the time the premises were occupied by the trustee, as an expense of administration."

The Court of Appeals in this connection relied upon *Schneider* v. *Springmann,* 25 Fed. (2d) 255, 256 (C. C. A. 6). The lease in that case, however, did not contain a conditional limitation. The provision was:

> "Should the lessee become bankrupt or go into involuntary liquidation, then in such event this lease shall become immediately forfeited."

The Sixth Circuit in that case took the view that the provision meant that the lease might be forfeited at the election of the lessor, and pointed out that a provision of that type was for the lessor's benefit, and that the party for whose benefit such a condition was provided generally had an election whether or not to insist upon it. The court further said that "forfeit" and "terminated" were not synonymous and that it would have been easy for the parties to have used "terminated", but that "forfeited" implied an election.

In our case the word is "terminated" and not "forfeited".

Subsection (b) of Section 110, Title 11, U. S. C. A. provides:

> "A general covenant or condition in a lease that it shall not be assigned shall not be construed to prevent the trustee from assuming the same at his election, and subsequently assigning the same; but an express covenant that an assignment by operation of law or the bankruptcy of a specified party thereto, or of either party, shall terminate the lease, or give the other party an election to terminate the lease, shall be enforceable."

This court in *Finn* v. *Meighan*, 325 U. S. 300, 65 S. Ct. 1147, in considering this section of the act, held, at page 1149, that the above provision of the act is merely declaratory of the law as it existed and that such provision is applicable in reorganization proceedings.

This section of the Bankruptcy Act makes a distinction between conditional limitation and condition subsequent provisions which the Court of Appeals in the instant case failed to observe. In so doing, it deprived the lessor of a right preserved to it by the Bankruptcy Act itself.

Conclusion.

It is respectfully requested that this petition for a writ of certiorari be granted.

Respectfully submitted,

VINCENT O'BRIEN,
Attorney for Petitioner.